

function income) is directly connected with such income and shall be allowable as a deduction in computing homeowners association taxable income to the extent that it qualifies as an item of deduction allowed by chapter 1 of the Code. Thus, for example, assume that X, a homeowners association, pays its manager a salary of \$10,000 a year and that it derives gross income other than exempt function income. If 10 percent of the manager's time during the year is devoted to deriving X's gross income (other than exempt function income), a deduction of \$1,000 (10 percent of \$10,000) would generally be allowable for purposes of computing X's homeowners association taxable income.

(d) *Investment credit.* A homeowners association is not entitled to an investment credit.

(e) *Cross reference.* For the definition of exempt function income, see § 1.528-9.

[T.D. 7692, 45 FR 26324, Apr. 18, 1980]

CORPORATIONS USED TO AVOID INCOME
TAX ON SHAREHOLDERS

**Corporations Improperly
Accumulating Surplus**

§ 1.531-1 Imposition of tax.

Section 531 imposes (in addition to the other taxes imposed upon corporations by chapter 1 of the Code) a graduated tax on the accumulated taxable income of every corporation described in section 532 and § 1.532-1. In the case of an affiliated group which makes or is required to make a consolidated return see § 1.1502-43. All of the taxes on corporations under chapter 1 of the Code are treated as one tax for purposes of assessment, collection, payment, period of limitations, etc. See section 535 and §§ 1.535-1, 1.535-2, and 1.535-3 for the definition and determination of accumulated taxable income.

(Secs. 1502 and 7805 of the Internal Revenue Code of 1954 (68A Stat. 637, 917; 26 U.S.C. 1502, 7805))

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 7244, 37 FR 28897, Dec. 30, 1972; T.D. 7937, 49 FR 3462, Jan. 27, 1984]

§ 1.532-1 Corporations subject to accumulated earnings tax.

(a) *General rule.* (1) The tax imposed by section 531 applies to any domestic or foreign corporation (not specifically excepted under section 532(b) and paragraph (b) of this section) formed or availed of to avoid or prevent the imposition of the individual income tax on its shareholders, or on the shareholders of any other corporation, by permitting earnings and profits to accumulate instead of dividing or distributing them. See section 533 and § 1.533-1, relating to evidence of purpose to avoid income tax with respect to shareholders.

(2) The tax imposed by section 531 may apply if the avoidance is accomplished through the formation or use of one corporation or a chain of corporations. For example, if the capital stock of the M Corporation is held by the N Corporation, the earnings and profits of the M Corporation would not be returned as income subject to the individual income tax until such earnings and profits of the M Corporation were distributed to the N Corporation and distributed in turn by the N Corporation to its shareholders. If either the M Corporation or the N Corporation was formed or is availed of for the purpose of avoiding or preventing the imposition of the individual income tax upon the shareholders of the N Corporation, the accumulated taxable income of the corporation so formed or availed of (M or N, as the case may be) is subject to the tax imposed by section 531.

(b) *Exceptions.* The accumulated earnings tax imposed by section 531 does not apply to a personal holding company (as defined in section 542), to a foreign personal holding company (as defined in section 552), or to a corporation exempt from tax under subchapter F, chapter 1 of the Code.

(c) *Foreign corporations.* Section 531 is applicable to any foreign corporation, whether resident or nonresident, with respect to any income derived from sources, within the United States, if any of its shareholders are subject to income tax on the distributions of the corporation by reason of being (1) citizens or residents of the United States, or (2) nonresident alien individuals to whom section 871 is applicable, or (3)

foreign corporations if a beneficial interest therein is owned directly or indirectly by any shareholder specified in subparagraph (1) or (2) of this paragraph.

§ 1.533-1 Evidence of purpose to avoid income tax.

(a) *In general.* (1) The Commissioner's determination that a corporation was formed or availed of for the purpose of avoiding income tax with respect to shareholders is subject to disproof by competent evidence. Section 533(a) provides that the fact that earnings and profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the income tax with respect to shareholders unless the corporation, by the preponderance of the evidence, shall prove to the contrary. The burden of proving that earnings and profits have been permitted to accumulate beyond the reasonable needs of the business may be shifted to the Commissioner under section 534. See §§1.534-1 through 1.534-4. Section 533(b) provides that the fact that the taxpayer is a mere holding or investment company shall be prima facie evidence of the purpose to avoid income tax with respect to shareholders.

(2) The existence or nonexistence of the purpose to avoid income tax with respect to shareholders may be indicated by circumstances other than the conditions specified in section 533. Whether or not such purpose was present depends upon the particular circumstances of each case. All circumstances which might be construed as evidence of the purpose to avoid income tax with respect to shareholders cannot be outlined, but among other things, the following will be considered:

(i) Dealings between the corporation and its shareholders, such as withdrawals by the shareholders as personal loans or the expenditure of funds by the corporation for the personal benefit of the shareholders,

(ii) The investment by the corporation of undistributed earnings in assets having no reasonable connection with the business of the corporation (see §1.537-3), and

(iii) The extent to which the corporation has distributed its earnings and profits.

The fact that a corporation is a mere holding or investment company or has an accumulation of earnings and profits in excess of the reasonable needs of the business is not absolutely conclusive against it if the taxpayer satisfies the Commissioner that the corporation was neither formed nor availed of for the purpose of avoiding income tax with respect to shareholders.

(b) *General burden of proof and statutory presumptions.* The Commissioner may determine that the taxpayer was formed or availed of to avoid income tax with respect to shareholders through the medium of permitting earnings and profits to accumulate. In the case of litigation involving any such determination (except where the burden of proof is on the Commissioner under section 534), the burden of proving such determination wrong by a preponderance of the evidence, together with the corresponding burden of first going forward with the evidence, is on the taxpayer under principles applicable to income tax cases generally. For the burden of proof in a proceeding before the Tax Court with respect to the allegation that earnings and profits have been permitted to accumulate beyond the reasonable needs of the business, see section 534 and §§1.534-2 through 1.534-4. For a definition of a holding or investment company, see paragraph (c) of this section. For determination of the reasonable needs of the business, see section 537 and §§1.537-1 through 1.537-3. If the taxpayer is a mere holding or investment company, and the Commissioner therefore determines that the corporation was formed or availed of for the purpose of avoiding income tax with respect to shareholders, then section 533(b) gives further weight to the presumption of correctness already arising from the Commissioner's determination by expressly providing an additional presumption of the existence of a purpose to avoid income tax with respect to shareholders. Further, if it is established (after complying with section 534 where applicable) that earnings and profits were permitted to accumulate beyond the reasonable needs of the